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HOUSE OF REPRESENTATIVES COMMITTEE ON WAYS AND MEANS SUBCOMMITTEE ON TRADE

HEARING ON THE OUTCOME OF THE SUMMIT OF THE AMERICAS AND PROSPECTS FOR FREE TRADE IN THE HEMISPHERE

Testimony of Daniel M. Price On Behalf of the Untied States Council for International Business***

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I. INTRODUCTION

Thank you for inviting me here today to present the views of the United States Council for International Business on the importance of including investment protections in the agreement establishing the Free Trade Area of the Americas (FTAA).

Trade and investment are interdependent. To achieve the benefits of economic liberalization, investment barriers must be addressed as comprehen-

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** The United States Council for International Business is a trade association of some 300 companies active in the global marketplace. Founded in 1945, the Council is dedicated to promoting an open system of world trade, investment, and finance. The Council advances the global interests of American business both at home and abroad. It is the American affiliate of the International Chamber of Commerce (ICC), the Business and Industry advisory Committee (BIAC) to the OECD, and the International Organization of Employers (IOE). As such, it officially represents U.S. business positions both in the main intergovernmental bodies and vis-à-vis foreign business communities and their governments.

sively as trade barriers. And the rules protecting U.S. investment abroad must be both rigorous and enforceable.

Taken together, the expansion of trade and investment flows has spurred economic growth, created jobs for millions of people in the United States and abroad, raised global living standards, and has helped forge bonds of mutual interest and economic opportunity among countries around the world.

International investment flows are rapidly becoming as important as trade in goods and services. The world economy is no longer characterized by companies that remain parked within national borders and that simply export or sell locally. Companies are investing abroad in ever-increasing numbers. They do so to get closer to their markets, acquire new technologies, form strategic alliances and enhance competitiveness by integrating production and distribution. The activities of their affiliates are impressive and make an enormous contribution to economic welfare worldwide. According to the United Nations World Investment Report 2000, sales by foreign affiliates of corporations totaled fourteen trillion dollars in 1999, over four times the figure for 1980 and twice the value of global exports. Foreign affiliates accounted for over three trillion dollars in exports in 1999. The production of foreign affiliates now accounts for approximately ten percent of global GDP, and foreign affiliates now employ over forty million people.

II. RESPONDING TO CRITICISMS OF INVESTMENT PROTECTION AND LIBERALIZATION

In spite of the economic significance of investment flows, some critics have suggested that promoting stable investment regimes abroad will lead to an export of American jobs. Some have also argued that investment liberalization will lead to a "race to the bottom" with investment flowing principally to countries with minimal or no protections for the environment or worker rights. The facts do not support these claims.

A. International Investment Flows- Inbound and Outbound- Contribute to the Economic Prosperity of the U.S.

The U.S. has been, perhaps, the greatest beneficiary of the explosion in international investment over the past decade. The United States receives more than 30% of worldwide investment. According to the U.S. Bureau of Economic Analysis (BEA), foreign investment in the U.S. grew seven-fold between 1994 and 2000, reaching almost three hundred seventeen billion dollars last year. As of 1998, foreign companies had invested over three point five trillion dollars in the U.S. They employed five point six million people and paid average annual salaries of over forty-six thousand dollars, well above the average salary for U.S. workers as a whole. U.S. subsidiaries of non-U.S. companies accounted for thirteen point five percent of all U.S. manufacturing jobs. In 1998, foreign companies' affiliates in the U.S. accounted for approximately twenty-two percent of total U.S. exports. Inbound investment is critical to the health of the U.S. economy.

Outbound investment is equally important. According to the BEA, between 1994 and 2000, U.S. outbound investment doubled from seventy-three billion dollars to one hundred forty-eight billion dollars. As of 1998, the assets of non-bank foreign affiliates of U.S. companies exceeded four trillion dollars. In 1998, non-bank foreign affiliates of U.S. companies had over two point four trillion dollars in sales- that is nearly two and one-half times the amount of U.S. exports of goods and services. According to the Survey of Current Business, exports by U.S. multinationals were four hundred thirty-eight billion dollars in 1998, an amount equal to some two-thirds of all U.S. exports. Approximately fifty percent of these exports were to the majority-owned affiliates of those U.S. companies. Thus, agreements promoting stable investment regimes abroad do not export jobs, but rather lead to increased exports of goods and services and contribute broadly to the economic well-being of the U.S.

B. Investment Liberalization does not Lead to a Race to the Bottom.

If lax environmental standards, low wages and the absence of worker rights were the principal determinants of investment flows, one would expect the least developed countries to be the host of the vast majority of foreign investment. Yet the reverse is true.

More than seventy-five percent of all foreign direct investment is in the developed world. As noted, the U.S. itself is host to more than thirty percent of all such investment. The United Kingdom runs a distant second with a little more than one-fourth the total of the U.S. or eighty-two billion dollars as of 1999. China, by contrast, received forty billion dollars in 1999, less than five percent of global flows. Thus investment has, in fact, raced to the top, flowing in overwhelming proportion to stable democracies that are characterized by high living standards, well-developed regulatory regimes and transparent legal systems.

The wage statistics are equally telling. In 1998, the average compensation paid to workers at majority-owned U.S. affiliates throughout the world was thirty-three thousand one hundred dollars. In Canada and Europe, which receive two-thirds of all U.S. outbound investment, the average compensation at U.S. majority-owned affiliates was forty-one thousand two hundred dollars. Investment has not "raced" to the lowest wage levels.

The critics confuse the cause and the cure: problems of environmental protection and labor standards are preeminently problems of economic development. Inadequate environmental standards and worker rights do not attract, and are not the result of, increased investment flows; rather they are in part the consequences of the *absence* of investment capital necessary to alleviate poverty and raise living standards- the root cause of the problem.

III. THE IMPORTANCE OF AN INVESTMENT CHAPTER IN THE FTAA

Our Latin American and Caribbean partners in the FTAA have experienced a dramatic surge in foreign investment over the past decade. The enormous opportunities that have opened up in the region- in large part as a result of massive privatization efforts- have made Latin American and Caribbean countries a primary destination for foreign investment among the developing countries around the world. The region now accounts for approximately ten percent of global FDI inflows. According to the United Nations, FDI in the region grew almost twenty- three percent between 1998 and 1999 alone, and as of 1999 stood at ninety billion dollars.

While the U.S. is the largest investor in the region, it has not kept pace with growth of investment opportunities there. According to the BEA, U.S. companies invested seventeen point seven one billion dollars in Latin America and the Caribbean in 1994. U.S. investment in the region in 2000 was virtually the same, at approximately seventeen point eight billion dollars. The U.S. is clearly not taking advantage of the investment boom in the region. In fact, most of the investment flows are between countries within the region, as they have already begun the process of economic integration without us. In addition, our major competitors, particularly from Europe, have stepped in to fill the vacuum.

An FTAA that both opens borders to trade and provides strong investment protections would create enormous commercial opportunities for U.S. industry and would unleash synergies in production and distribution operations. Trade liberalization without investment liberalization will prevent companies from achieving these synergies and rationalizing their supplier networks. Conversely, investment liberalization without trade liberalization will lead to the creation of duplicative production operations as producers are forced to build manufacturing facilities behind the "tariff walls" protecting each market. Investment protection and liberalization is thus a crucial part of a free trade agreement.

In addition to these economic benefits, an investment chapter would promote broader U.S. policy goals. Investment agreements negotiated by the U.S. essentially incorporate U.S. constitutional protections against the taking of property without just compensation and against arbitrary or discriminatory government actions. As they have done in the U.S., these principles foster development of the rule of law, respect for private property and a market-based free enterprise system that are essential hallmarks of a democratic society.

Recognizing these important dynamics, some thirty leading U.S. companies and trade associations wrote to Ambassador Zoellick on April 19 affirming their support for inclusion of an investment chapter in the FTAA modeled on the strong and comprehensive provisions found in NAFTA.

IV. THE NEED FOR STRONG LEGAL PROTECTION OF FOREIGN INVESTMENT: CORE ELEMENTS OF AN INVESTMENT CHAPTER

The explosive growth in cross-border investment is attributable to several factors, not the least of which is the development of strong, stable legal regimes to protect property rights. Over the past decade, we have witnessed a sea change in the way countries- particularly developing countries- have treated foreign investment. Whereas before they pursued economic growth through state control of the private sector and import substitution policies, they have come to realize that growth is best promoted through free trade and liberal investment regimes. Countries in Latin America in particular have undertaken vast privatization efforts and have revamped their legal systems to attract foreign investment.

According to the United Nations, of one thousand thirty-five changes worldwide in laws governing foreign direct investment between 1991 and 1999, ninety-four percent were more favorable to foreign investment. The number of bilateral investment treaties (BITs) has risen from one hundred eighty-one at the end of 1980 to one thousand eight hundred fifty-six at the end of 1999. Countries in Latin America and the Caribbean have signed approximately three hundred BITs, virtually all of which were negotiated in the 1980s and 1990s. As of December 31, 1996, the countries of Latin American and the Caribbean had negotiated thirty-seven BITs among themselves all in the 1990s. It is no coincidence that these changes to the legal landscape have occurred at the same time as cross-border investment has expanded over the past decade.

It should be noted, however, that the U.S. has signed investment agreements with only three of the top ten Latin American recipient countries of foreign investment. The FTAA would include six of the remaining seven markets.

Including an investment chapter in the FTAA would help lock in these advances in creating a regulatory environment hospitable to international investment. While strong investment laws are not themselves sufficient to attract foreign investment, they are a necessary prerequisite for such investment. A recent study by economists at the Inter- American Development Bank found that strong investment laws, particularly laws protecting foreign investors from expropriation and preserving contract rights, play central roles in attracting FDI. It also found that free trade agreements significantly increase investment among the members of the free trade area.

In order to establish a strong investment regime throughout the Hemisphere, the FTAA should include all of the fundamental protections that have been codified in U.S. bilateral investment treaties and in Chapter 11 of the NAFTA. The U.S. has sought the inclusion of these principal protections in bilateral and multilateral investment agreements since World War II when it began negotiating a series of modern treaties of friendship, commerce and navigation (FCN). The investor-state dispute settlement mechanism was included in the first U.S. bilateral investment treaty (on which all subsequent U.S. BITs have been based) in 1980.

What are these fundamental protections?

First, the investment chapter should guarantee foreign investors the better of national treatment or MFN treatment, both with respect to the establishment of investments and treatment thereafter. This will ensure nondiscriminatory treatment and the removal of barriers to entry.

Second, the FTAA should protect investors against expropriation without payment of compensations. This protection should extend both to direct expropriation- for example, the physical taking or nationalization of property- and to indirect expropriation such as may occur through regulation or other forms of so-called creeping expropriation. The inclusion of indirect expropriation is crucial. Government action may impair or destroy the value of an investment even if there is no physical seizure or destruction of the property.

Third, the investment chapter should guarantee investment fair and equitable treatment, full protection and security, and protection in accordance with international law. These provisions have long been included by the U.S. in bilateral and multilateral investment instruments. The fair and equitable treatment standard, in particular, protects against lawless, arbitrary, unreasonable, bad faith or other justifiable government actions. These protections help promote the rule of law and are meant to safeguard the interests of U.S. investors where government action or inaction, while not rising to the level of expropriation per se or outright discrimination on nationality grounds, nonetheless subjects the investor to adverse and injurious treatment.

Fourth, the investment chapter should guarantee the free movement of capital associated with the investment, including the repatriation of profits. Without this protection, investors will not commit the resources necessary to undertake large-scale investments.

Fifth, the investment chapter should prohibit performance requirements such as local content and export requirements, and other trade- related investment measures. Such measures distort trade flows and create economic inefficiencies, thereby offsetting the benefits of the agreement.

Finally, the investment chapter should include a mechanism to allow investors to arbitrate investment disputes with host governments and obtain monetary compensation for damages resulting from violations of the agreement. Access to an arbitration procedure of this sort is the only effective way to guarantee enforcement and obtain appropriate redress. Limiting investment dispute settlement to a state-to-state procedure will politicize disputes, leaving investors, particularly small-and medium-sized enterprises, with little recourse save what their government cares to give them after weighing the diplomatic pros and cons of bringing any particular claim. Furthermore, a state-to-state dispute settlement procedure based on the WTO model, which provides only prospective relief, will not remedy most violations of the agreement. If, for example, a government expropriates an investor's property, prospective relief without providing compensation to the investor will not redress the injury done to the investor.

V. RESPONDING TO CRITICISM OF NAFTA's INVESTOR-STATE DISPUTE SETTLEMENT MECHANISM

The investor-state dispute settlement mechanism has been perhaps the most controversial aspect of the investment chapter of the NAFTA. Critics have alleged that it undermines a nation's sovereign right to regulate. The evidence simply does not support these claims.

At the outset, two facts should be recognized. First, under NAFTA an investor- state arbitral tribunal can only award the payment of compensatory money damages to an injured investor; tribunals have no authority to order a party to change its laws. Second, it is U.S. investors that have more capital at risk than investors from any other country, and thus have the most to gain from an effective mechanism for enforcing investor protections.

In any case, there is no evidence that arbitration tribunals will jeopardize public welfare to uphold the economic interests of foreign investors. A careful examination of the NAFTA arbitration decisions to date reveals that the tribunals have acted with great care. In two cases where an arbitration tribunal ruled in favor of a U.S. foreign investor- *SD Myers* and *Metalclad*- the tribunal found that the government authorities were acting arbitrarily or targeting a specific foreign investor with unfair or discriminatory measures. It should be noted that Mexico brought suit in a Canadian court to set aside the *Metalaclad* award, and the court recently upheld the tribunal's decision that the U.S. investor's property had been expropriated. In two other cases- *Azinian* and *Waste Management*- the U.S. investor lost outright, one on the merits, the other on jurisdiction.

In the recently released decision in *Pope & Talbot*, the tribunal rejected all but one of the U.S. investor's claims. The one claim that was upheld was based on a finding that the Canadian authorities had acted unfairly in imposing extremely burdensome, and arguably illegal, administrative requirements on the investor. While the tribunal was careful to avoid questioning the motives of the Canadian Government in that case, it appeared from the facts that the Government's actions were motivated by a desire to punish the investor for bringing the NAFTA claim.

In *Ethyl-* which is often cited by critics as an example of a case where a foreign investor forced a government to withdraw a bona fide environmental measure- Canada settled a NAFTA case brought by a U.S. investor. However, the settlement was spurred by a holding by a Canadian panel, not the NAFTA arbitration tribunal, that the particular measures imposed by Canada violated an internal Canadian arrangement called the Agreement on Internal Trade.

This track record hardly demonstrates that arbitration tribunals have overstepped their bounds in protecting the rights of investors. To the contrary, the evidence to date shows that tribunals have taken a reasonable, balanced and judicious approach in interpreting and applying the NAFTA investment provisions.

Nevertheless, critics of the NAFTA investment chapter point to cases against the U.S. that have not yet been decided- such as the *Methanex* or *Loewen* cases- and have speculated about how tribunals in those cases might rule. Indeed, those critics find troubling the very initiation of these claims. I do not express a view on the merits of these pending cases. However, the mere fact that cases have been brought against the U.S. in no way undermines the legitimacy or integrity of the dispute settlement process. Indeed even frivolous cases may be brought before a NAFTA panel just as they are brought in the U.S. courts every day, but this does not mean that either the court system or the arbitration mechanism is flawed. If claims are found to be frivolous, then they will be rejected. If claims are justified, then the respondent, including the U.S. as the case may be, should pay compensation. This is the price of living in an international system governed by the rule of law.

The U.S. has long been the champion of international investment rules. It has fought hard for recognition of the international rule of law and for respect for international dispute resolution bodies. The U.S. has enjoyed enormous benefits from invoking dispute settlement provisions to break down trade barriers or redress injuries to investors. Indeed, of the approximately thirty claims under BITs that have come before the International Center for Settlement of Investment Disputes (ICSID), about one-third have been brought by U.S. investors. And of the sixteen claims that have been brought under NAFTA's investment provisions, eleven have been brought by U.S. investors. It would be ironic if the U.S., long the advocate for subjecting sovereign actions to scrutiny under international law, were now to retreat from the very international principles it worked so hard to enshrine.

Concerns about investor-state arbitration- and agitation over its compatibility with sovereignty- are without foundation. Fears about overreaching arbitral panels are likewise unfounded given the record of decisions.

None of this should be taken to imply that the system could not be improved. The process would benefit from two important changes. First, the FTAA parties should consider increasing the transparency of the process by ensuring that the briefs and arbitration proceedings are open to public view, subject to reasonable protections for confidential business information. An amicus, or "friend of the court," procedure might also be developed where by interested members of the public could express their views on the issues before the tribunals.

Second, the parties to the FTAA might consider the desirability of creating an appellate body that would review arbitral awards for errors of law. Such an appellate mechanism would accomplish three salutary goals: (1) it would address the risk of an aberrant or wildly erroneous decision that seems to have captured the imagination of critics; (2) it would contribute to the development of a coherent body of jurisprudence on the interpretation of the FTAA; and (3) it would eliminate the possibility of having the court systems in each of the thirty-four FTAA parties become involved in the review of FTAA awards and hence the interpretation of FTAA, a possibility left open by NAFTA.

VI. CONCLUSION

The Hemisphere stands at the threshold of comprehensive free trade agreement talks in which investment rules should figure prominently. Investor-state dispute settlement will be essential to ensuring the effectiveness of those rules. Now is not the time to depart from longstanding U.S. investment policy and time-tested methods for the resolution of investment disputes.

As the largest economy in the region, the U.S. has the most at stake in the hemispheric integration. By leading the negotiation of an agreement that removes trade and investment barriers and promotes democratic values, the U.S. can secure for itself and its neighbors the benefits of economic growth and prosperity. An investment chapter is an essential component of any agreement seeking to achieve these goals.